

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
June 20, 2002
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the Rouge Room of the Little America Hotel, located at 2515 East Butler Avenue, Flagstaff, Arizona, 86004. Mr. Jim Bruner, Chairman, ASRS Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS Phoenix office, 14th floor conference room, 3300 North Central Avenue, Phoenix, Arizona, 85067 and to the Tucson Office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona, 85710.

1. Call to Order; Roll Call

Present: Mr. Jim Bruner, Chairman
Mr. Norman Miller, Vice Chairman
Ms. Charlotte Borchert
Dr. Chuck Essigs
Ms. Bonnie Gonzalez
Mr. Alan Maguire
Mr. Karl Polen (via teleconference)
Mr. Ray Rottas
Mr. Carl Tenney

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the May 17, 2002, Regular Meeting of the ASRS Board

Motion: Mr. Alan Maguire moved to approve the minutes of the May 17, 2002, regular meeting of the ASRS Board.

Mr. Ray Rottas seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

3. Board Approval of Consent Schedule

Motion: Mr. Alan Maguire moved to approve the consent agenda:

- A. Retirements, Refunds and Death Benefits
- B. System Transfers
- C. Application and Agreements with the Following Employers:
 - Peak School, Inc.
 - Town of Camp Verde
 - Tri-City Vo-Tech High School
 - Flagstaff Arts & Leadership Academy
 - Pima Prevention Partnership
- D. Contract Extension of Deloitte & Touche for External Audit Services
- E. Contract Extension of CB Richard Ellis to manage and lease the 3300 Tower and Broadway Proper
- F. Contract Extension of VPA, Inc. to administer the Long Term Disability Program
- G. Contract Extensions of the following Investment Managers:
 - JP Morgan Large Cap Active Equity
 - Mellon Equity Large Cap Active Equity
 - Barclays Global Investors Large Cap Passive Equity
 - Barclays Global Investors Tactical Asset Allocation
- H. Investment Policy & Procedures, "Securities Lending Compliance"
- I. Lump Sum Distribution of Benefit Increase to Marian Traynor to Qualify for Arizona Long Term Care System

Mr. Norman Miller seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

4. Presentation, Discussion, and Appropriate Action Regarding Adoption of the Supplemental Defined Contribution (DC) Plan/Modified Deferred Retirement Option Program (DROP) Rule as an Emergency Measure and Direction to Staff to Initiate the Permanent Rulemaking Procedure for the Supplemental DC Plan and for the Modified DROP

Mr. Fred Stork, Assistant Attorney General, reported that in order to implement the DC Plan (or Supplemental Retirement Savings Plan (SRSP)) and the DROP program, the Board must promulgate a rule in accordance with the Administrative Procedure Act. The ASRS is waiting for a letter of determination from the Internal Revenue Service (IRS). In order to have the programs immediately available to members upon receipt of a favorable IRS ruling, staff recommends the Board adopt an emergency rule as a temporary measure to avoid delay. In the mean time, the regular rulemaking process will be initiated to promulgate a permanent rule.

Motion: Mr. Alan Maguire moved to find that an emergency exists and that compliance with the notice and public participation requirements of the Administrative Procedure Act are impracticable; and moved to adopt an emergency Supplemental Defined Contribution Plan and Modified Deferred

Retirement Option Program rule to allow the programs to be functional, with member participation, as soon as the IRS rules; and moved to allow staff to make any technical or formatting changes to comply with the required rulemaking procedures, without changing the intent or meaning. He also moved to direct staff to file a Notice of Proposed Rulemaking for the Supplemental DC Plan and for the Modified DROP with the Secretary of State and to take any other actions necessary and appropriate to comply with the required procedure for adopting permanent rules.

Mr. Ray Rottas seconded the motion.

Mr. Norman Miller asked whether the plan submitted to the IRS is a prototype or unique plan, and what the potential impact of the IRS decision on the rule and on the member participants would be. Mr. Stork responded that the plan is unique and for this reason, along with the IRS workload due to federal legislative changes, a decision has not been made. The IRS has also not provided enough information to indicate what, if any, changes to the plan may be required. However, the ASRS will not begin to implement the program until the IRS rules, so as not to disrupt the activities of participants.

Mr. Alan Maguire commented that when the Board adopted the DROP program, outside consultants who helped structure the plan characterized it as being generally consistent with other plans. However, the ASRS plan contains a couple of provisions that are relatively aggressive - for the benefit of employees - but it may be those provisions that are causing delay. If the IRS agrees to those provisions, it may set a new standard for other plans across the country.

Dr. Chuck Essigs noted that DROP participation is irrevocable and asked what happens if a member becomes disabled. Mr. Stork answered that as the plan is now structured, although unfortunate, if someone becomes disabled, they would be terminated from the program; it would require state legislation to change that provision. Dr. Essigs asked whether employers would be provided the appropriate enrollment forms so that there is a consistency among employers. Mr. Stork answered that providing a standard form for employers is the current ASRS practice.

Mr. Miller asked, for the record, Mr. Stork's legal opinion as to the Board's authority to promulgate and implement the emergency rules. Mr. Stork answered affirmatively.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

5. Presentation, Discussion, and Appropriate Action Regarding the Mid Cap Request for Proposal (RFP) Award

Mr. Alan Maguire, Chairman, RFP Evaluation Committee, reported that the ASRS issued a Request for Proposal (RFP) for U.S. Equity Mid Cap portfolio managers at the beginning of the year as part of the regular review of investment managers. The committee interviewed and narrowed down the candidates. He pointed out the allocation of the Mid Cap portfolio and said that staff has worked to negotiate the best possible fees and deal for the ASRS.

Mr. Maguire noted that the fee methodology and structure are different from any used previously, and he would like to discuss them in more depth at a future Board meeting.

Motion: Mr. Alan Maguire moved to award, fund, and terminate mandates for Domestic Equity Mid Cap investment management according to the following:

CORE	Award Franklin Portfolio Associates Award Wellington Management Retain State Street Global Advisors Terminate Mellon Equity
GROWTH	Award Frontier Capital Management Award Forstmann-Leff Retain the Internally Managed E3 Portfolio
VALUE	Award Wellington, on an Unfunded Basis, as an Alternative Manager Fund the Internally Managed E4 Portfolio

with fees as outlined in the schedule titled “Mid Cap Negotiations,” and for contract awards for one year with up to four renewal periods of one year each, and with pro rata dollar allocations according to the table titled “Approximate Mid Cap Allocations.”

Mr. Carl Tenney seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

6. Presentation, Discussion, and Appropriate Action Regarding Approval of the Supplemental Retirement Savings Plan (SRSP) Investment Options

Mr. Alan Maguire, Chairman, Defined Contribution Plan Committee, reviewed the process of developing the SRSP and selecting the administrator, TIAA-CREF, for the program. At the time of the selection, one outstanding issue was the available investment options to participants of the plan.

The committee evaluated the available investment alternatives, including some that TIAA-CREF is in the process of negotiation with vendors, and recommended that 13 of the investment options be approved for the ASRS SRSP participants.

Motion: Mr. Alan Maguire moved to approve the 13 Supplemental Retirement Savings Plan investment options, as outlined in the table titled “Summary of Recommended Investment Options,” subject to modifications that may be required pursuant to negotiations between TIAA-Cref and its investment offering counter parties, as authorized by the ASRS executive team after dissemination to the Board.

Dr. Chuck Essigs seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

Mr. Norman Miller asked where the title “Savings Plan” originated, as the plan is really an investment opportunity rather than a traditional savings plan. Mr. Maguire responded that the plan

was originally referred to as the Defined Contribution Plan. The committee wanted to make it clear that purpose of the new plan is an additional option, rather than an alternative, to the current ASRS Defined Benefit Plan. The committee also wanted to clarify that the plan is inflexible with regards to withdrawal because it is not a short-term investment, but rather a plan meant to supplement retirement savings. Mr. Maguire also reminded the Board that TIAA-CREF has an excellent educational program designed to help members distinguish between the plans. Dr. Essigs added that TIAA-CREF has been instructed to assist members examine all the benefits available through the ASRS and state programs.

7. Presentation, Discussion, and Appropriate Action Regarding Selection of the Project Director and Staff for the Information Technology Plan

Ms. Bonnie Gonzalez, Chairman, Budget and Long Range Planning (BLRP) Board Committee, reported that an RFP was issued for the Project Director for the Information Technology (IT) Plan. Based on the evaluation and interviews, and the firm's experience and references, the committee makes a unanimous recommendation.

Motion: Ms. Bonnie Gonzalez moved that the contract for Project Director and Staff for the Information Technology Plan be awarded to Tier Technologies.

Ms. Charlotte Borchert seconded the motion.

Ms. Borchert commented that, as a new member of the Board, she was impressed with the process and the information and insights provided by staff. Mr. Bruner concurred.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

8. Presentation, Discussion, and Appropriate Action Regarding an Update on Health Insurance

Dr. Chuck Essigs, Chairman, Health Insurance and Long Term Disability Board Committee, provided an update of ongoing activities with regard to the challenges of providing affordable health insurance to members. In January 2003, the current health care programs are up for renewal. The ASRS has been working with the major retiree organizations to look at the options and recommend something for the future. The meetings have been productive in helping members understand the problems and address the underlying issues. Dr. Essigs cited statistics that show that many retirees are not participating in the ASRS health care plans, apparently because of the high cost. The committee has been looking at options such as self-insurance, new health delivery models, and pooling with other groups in considering possible solutions.

9. Presentation, Discussion, and Appropriate Action Regarding the Board Governance Request for Proposal

Mr. Jim Bruner reported that the proposed Scope of Work for the RFP for a governance consultant was distributed to Board members for comment. He incorporated many of those comments into the document before the Board.

Mr. Alan Maguire commented that his understanding of the initial discussion about the RFP was that the consultant would review all aspects of the ASRS. Mr. Maguire believes the draft RFP too narrowly addresses only the Board instead of the Board, committees of the Board, administration of the agency, and internal organizations. He believes the consultant should be someone who has worked both in and out of Arizona because the Arizona Constitution proposes certain restrictions on the operation of government agencies that may not be applicable in other states. Mr. Maguire suggested a survey of 10-15 states be conducted to identify alternative retirement system structures that may be analyzed and presented to the Board

Motion: Mr. Alan Maguire moved that the Scope of Work for the Board Governance RFP be held or completely modified to include the entire organization, management and governance of the ASRS.

Mr. Ray Rottas commented that the ASRS Board is administrative, while the governor and legislature are the trustees. He believes the Board should be cautious in tinkering too much with a successful system, but if there is something that should be reconsidered, it needs to be verified by statutes because statutes govern the system.

Mr. Carl Tenney seconded the motion.

Ms. Borchert commented that she also believed the purpose of the governance exercise was to examine the entire agency. While she supports the idea that the Board is an integral part of the study, the draft RFP leaves out other essential pieces.

Mr. Norman Miller said he believes the role of the legislature and its committees is to review the structure of state agencies from time to time, with the assistance of outside help. He asked whether the agency itself or how the Board conducts itself within the existing system should be examined separately or whether they should be looked at concurrently.

Mr. Maguire responded that when he participated in a similar exercise in 1983, three part-time staff completed the analysis in three months. He clarified that in Arizona, the Board is an essential part of the system; it is not an advisory Board, but a management Board. The Board and its committees are directly related to the overall structure of the system and the distribution of responsibilities, so the system and Board cannot be looked at in isolation. The current Scope of Work presupposes the existing administrative structure is appropriate and can only recommend how the Board could interact within that structure.

Mr. Bruner stated he believed broader language was added to the scope to adequately cover a review of other systems and provide a broad base to look at the process as a whole. Mr. Maguire stated that the detailed instructions of the Scope are not as broad and only include the Board. He reiterated that the ASRS Board is dramatically different than other boards, as the purpose of this Board is principally and primarily to protect the trust fund created by the State of Arizona on behalf of the current and future retired members of the system. As this is the largest single financial asset of the state, it is a completely different trust relationship than with other boards.

Mr. Karl Polen asked Mr. Maguire what kind of questions he believed should be answered by looking at the internal structure of the organization. Mr. Maguire responded that he would like to look at the general organizational structure and the allocation of the responsibilities between the divisions in the agency. Mr. Polen clarified that the purpose would not be to look at policy, but rather duties and interactions of divisions of the agency, as well as the Board. Mr. Polen does not believe that is inconsistent with the RFP, but wants to see any specific changes to the document before the RFP moves forward.

Dr. Chuck Essigs believes this is a two-step process: 1) The Board should understand what their role is and what role they may want to play, and 2) then look at an administration that is consistent with that role and structure.

Mr. Carl Tenney agreed that both the Board and the ASRS organization need to be examined, and both elements should be written into the RFP so that the project is clearly defined.

Amended Motion: Mr. Alan Maguire moved that the RFP be held until the language of the Scope of Work is refined to be more comprehensive.

Mr. Ray Rottas seconded the motion.

Mr. Karl Polen expressed his hope that the RFP keep moving as quickly as possible and that it not be delayed until the August Board meeting. He also wants to ensure that the exercise takes a broad look at the administrative structure as it relates to the mission of the Board as assigned by statute. Dr. Essigs concurred.

Mr. Bruner appointed an ad hoc committee of himself, Mr. Maguire and Mr. Polen to work on the draft RFP and bring it back to the Board.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the amended motion was approved.

10. Presentation, Discussion, and Appropriate Action Regarding the Pending Retirement of the Director

Mr. Bruner reported that Mr. LeRoy Gilbertson, Director, intends to retire after 30 years of public service. Mr. Gilbertson has given of date of January 6, 2003, but has indicated his willingness to remain for a reasonable time until a successor can be named.

Motion: Mr. Ray Rottas moved that Mr. Gilbertson be retained as the Director until January 6, 2003, or his replacement is retained.

Mr. Alan Maguire seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

Mr. Bruner suggested that the Board engage a professional search firm to find potential applicants

for the Board's review. Dr. Essigs concurred and believes the Board should pick a firm that has expertise in retirement systems. Mr. Maguire agreed that using a firm for the search is a good idea, but the narrowing and selection of potential candidates is better done by personnel professionals within the state of Arizona, such as personnel within the Arizona Department of Administration (ADOA). Mr. Rottas commented that ADOA assisted in the past and did an excellent job of providing candidates. Ms. Borchers agreed but wants to be sure the Board retains the authority to add people to that list. Ms. Gonzalez also wanted to ensure that by using ADOA the list isn't marginalized or that people aren't eliminated by ADOA criteria that the Board wouldn't necessarily want to be eliminated. Mr. Bruner agreed that it is the duty of the Board to give clear direction as to what it wants.

Mr. Gilbertson said the ASRS could put together the RFP for the search firm. Mr. Bruner asked that the RFP be returned to him for dissemination to the rest of the Board for input. Mr. Maguire also suggested it may be beneficial to advertise the upcoming vacancy well in advance to generate interest at an earlier stage.

11. Election of Board Officers for Fiscal Year 2002/2003

Dr. Chuck Essigs suggested the Board consider changing the election of Board officers to coincide with the calendar, rather than the fiscal year, to coincide with the calendar-year terms of Board members. Mr. Maguire noted that the Board may also want to look at the statute changing the Board member's terms to fiscal year.

Motion: Dr. Chuck Essigs moved to elect current Vice Chairman Norman Miller as Chairman of the ASRS Board, for the term July 1, 2002 through June 30, 2003.

Mr. Jim Bruner seconded the motion.

Substitute Motion: Ms. Charlotte Borchers moved to elect Alan Maguire as Chairman of the ASRS Board, for the term July 1, 2002 through June 30, 2003.

Mr. Carl Tenney seconded the motion.

Ms. Bonnie Gonzalez commented that the Board should remember its role is to work as a cohesive group to accomplish what is best for the system and its members.

By a vote of 5 in favor, 4 opposed, 0 abstentions, 0 excused, the substitution motion was approved.

Motion: Dr. Chuck Essigs moved to elect Bonnie Gonzalez as Vice Chairman of the ASRS Board, for the term July 1, 2002 through June 30, 2003.

Ms. Charlotte Borchers seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

12. Director's Report

There were no comments regarding the Director's Report.

13. Board Requests for Agenda Items

Mr. Bruner noted that some items had already been requested during the meeting.

14. Call to the Public

There were no requests to speak from the Flagstaff, Tucson, or Phoenix public.

15. The next ASRS Board meeting is scheduled for Friday, August 17, 2001 at 8:30 a.m. in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910.

16. Adjournment of the ASRS Board.

Mr. Jim Bruner, Chairman, adjourned the June 20, 2002 meeting of the ASRS Board at 9:50 a.m.

Respectfully submitted,

Maurah Harrison, Secretary

Date

LeRoy Gilbertson, Director

Date